



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
NOVEMBER 2002**

DATE: January 13, 2003

Approved

Date

The Monthly Financial Report (MFR) for November has been jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

OVERVIEW

Continuing recent trends, total revenue collected in the General Fund through November was down from the same period in the prior year for a fifth consecutive month, illustrating the persistent negative impact of the severe economic downturn which continues to plague the local economy. November collections actually reflected a slight overall deterioration, and if this pattern continues, it now appears that the City would face a year-end General Fund revenue budget shortfall in the range of \$4.0-8.0 million.

Negative new information of particular note was received since our last report concerning our largest economically sensitive revenue category – General Sales Tax. Although not reflected in the November numbers contained in this report, the City received First Quarter General Sales Tax receipt information in late December. The news was not good. Receipts were down significantly for a sixth consecutive quarter, falling 9.6% from the prior year level. This was particularly disturbing because that drop was in comparison with poor prior year quarter that had itself been down by 19.8% from the 2000-2001 level. This report reflects Sales Tax collections which have now fallen to a level last experienced four years ago in 1998-1999. As revised in October as part of the Annual Report process, the current budget assumes flat growth in the General Sales Tax category. In order to meet that revised budget level, we would need to achieve General Sales Tax growth averaging 2.5% for the remainder of the year. That would appear to be an unlikely outcome given recent performance. Thus, it is likely that a further downward of adjustment for this estimate will be necessary as part of the Mid-Year Budget Review.

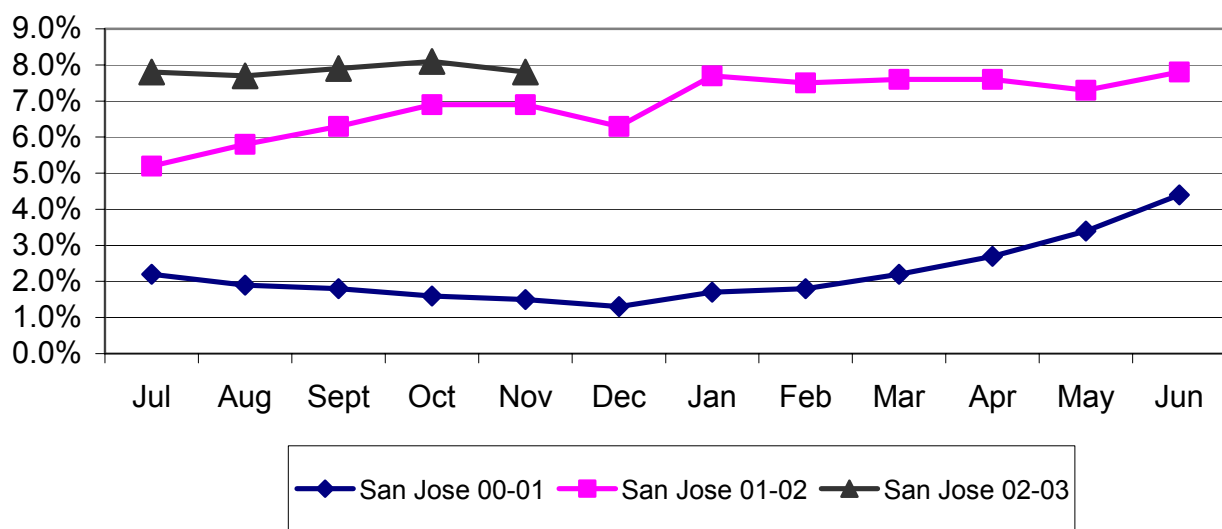
Further, all of the City's economically sensitive revenues continued to perform poorly in November. Building, Planning, Fire and Public Works development services cost-recovery revenue continued to be below anticipated levels, which already presumed extremely low activity. Construction tax collections illustrated the dismal state of the construction industry. Construction Excise Tax revenue dropped 4.9% below last year's depressed level, while

OVERVIEW (CONT'D.)

Building and Structures Tax dropped by an even greater amount (down 13.2%). As discussed in the most recent edition of the Silicon Valley Business Journal, San Jose and Silicon Valley now have the dubious distinction of suffering the worst drop in the pace of new construction in the State. Although construction of new single family home production as well as new retail has remained reasonably strong, declines in commercial sectors such as industrial properties and new offices have been so profound as to pull the entire industry down to approximately 1996 levels.

Locally, the unemployment rate as well as the number of wage and salary jobs remain the strongest indicators of just how weak the local economy is. While the November Santa Clara County unemployment rate of 7.8% was down slightly from October's revised rate of 8.1%, it was still well above both the State and national rates (6.3% and 5.7%, respectively). Even with the slight improvement over the prior month, the County rate is almost a full percentage above last November's already depressed post September 11 rate, illustrating the continued severity of the economic decline in the area. The news concerning the number of jobs in the area for November also continues to be discouraging. The total number of wage and salary jobs in the County was estimated at 960,100 (down by 3,600 from the revised October level of 963,700). According to the California Employment Development Department, the manufacturing sector recorded a net loss of 2,400 jobs over the month. Over four-fifths of that drop occurred in our most important economic sectors: electronics equipment, industrial machinery, and instruments and related products industries.

San José Metropolitan Statistical Area
(Santa Clara County)
Unemployment Rate Comparison



Adding to this dismal picture, on Friday, January 10, the Governor released his Proposed Budget for the 2003-2004 fiscal year. Facing the prospect of an approximate \$35.0 billion shortfall over the next 18 months, the Governor's proposed budget contains a mixture of proposals, some

OVERVIEW (CONT'D.)

taking effect immediately and some intended to be in effect next year. Unfortunately, this budget contains a number of proposals that would be devastating for the City of San Jose. Validating our long-standing worst fears, and in direct contradiction to previous promises not to balance the State's budget on the backs of local government, adoption of the Governor's budget would completely eliminate the State backfill of Vehicle License Fees beginning in February. That one action alone would reduce City revenues by \$17.7 million in the current fiscal year, and \$36.1 million next year and annually thereafter. In addition, the budget contains proposals that would cut State Library Funds by \$413,000, eliminate the Booking Fee Reimbursement (\$2.5 million), and suspend indefinitely Proposition 42 Street Maintenance funding (\$2.0 million annually). Enactment of these actions taken together would cost the City General Fund approximately \$18.1 million this fiscal year and approximately \$39.1 million in 2003-2004, for a cumulative impact of \$57.2 million. Added to our previously projected shortfall in the General Fund for next year of \$63.0 million, we now face the prospect of having to close a \$120.2 million funding gap. Putting this amount into perspective, that gap is approximately 16.6% of the entire General Fund, and 31.7% of the non-public safety General Fund budget.

In response to the deteriorating economic situation, actions by the City Council and Administration have followed the conservative fiscal practice model that has served the City well in the past. Downward revenue adjustments of \$15.0 million to the Adopted General Fund Budget were recommended and approved in October as part of the City Manager's 2001-2002 Annual Report.¹ Three reserves (one of \$10.9 million to address future deficits established through the Annual Report, the Reserve for Economic Uncertainty of \$15.7 million, and the General Fund Contingency Reserve) were not utilized during the recent budget process and remain intact. Finally, as reported in earlier MFRs, the Administration has maintained the hiring freeze in place since November 2001, and implemented new cost/position management plans which assign departmental reduction savings targets for 2002-2003 totaling approximately \$8.7 million. Given the latest General Sales Tax results and the Governor's Proposed Budget, additional strategies may need to be considered for the City to remain within budget during the current fiscal year.

The next major fiscal update regarding the fiscal situation will come in February when City Council is scheduled to consider the Mid-Year Budget Review. The Mid-Year Review document is scheduled to be released at the end of January. Between now and the release of that report, the Administration will implement immediate expenditure controls, conduct a comprehensive evaluation of current costs and revenues in all funds, and formulate recommendations to be included in that report regarding any further actions believed necessary.

¹ The downward adjustments were offset by higher than anticipated year-ending fund balance, and unanticipated revenue that will be available from the sale of surplus property.

GENERAL FUND

Revenue Collections

General Fund revenues collected through November 2002 totaled \$222.1 million. This was a decrease of \$11.7 million (down 5.0%) from the November 2001 level of \$233.8 million. Excluding one-time, settlement revenue received last year from the County, the decline was approximately 2.7% (down \$6.2 million). This decline reflects decreases in the following revenue categories: Sales Tax, Transient Occupancy Tax, Utility Tax, Licenses and Permits, Use of Money and Property, Revenue from the State of California, Revenue from the Federal Government, and Other Revenue. Declines in those revenue categories were only partially offset by increases in the following revenue categories: Property Tax, Franchise Fees, Revenue from Local Agencies, Departmental Charges, as well as Transfers and Reimbursements.

The following discussion highlights General Fund activities through November:

KEY GENERAL FUND REVENUES (\$000's)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Property Tax	\$ 86,278	\$ 21,730

Year-to-date Property Tax revenues reflect collections in Secured Property Tax, Unsecured Property Tax, and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Secured Property Tax revenues through November represent advances only and are not necessarily reflective of final collections. Information from the County does indicate, however, that this category will end the year slightly over budgeted expectations.

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through November, Unsecured Property Tax receipts of \$11.9 million, reflected flat growth over the prior year. Given the state of the local economy, this performance is actually better than anticipated. It should be noted, however, that performance in this category over the past decade has been extremely volatile and subject to sharp changes as the economy shifts. Staff will continue to monitor this revenue source closely and work with the County to obtain additional information to assist with year-end estimates.

Through November, SB 813 payments of \$796,000 tracked 33.3% below last year's collection level of \$1.2 million. Collections in this category, representing payments for taxes owed on recent housing re-sales, are typically a leading indicator of sales activities. The Adopted Budget anticipated a 10% decline in this category, but the actual drop has exceeded the budgeted expectation. Staff will continue to watch this revenue source closely and assess whether an additional downward adjustment may be necessary later in the year.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Sales Tax	\$ 137,552	\$ 35,611

As mentioned earlier, 2002-2003 first quarter General Sales Tax receipts (received in December and therefore not reflected in the numbers in this report) fell 9.6% from the same quarter in the prior year. The 2002-2003 first quarter collection represents activity that occurred during July through September. While this performance may be a slight improvement over the prior four quarters of double-digit declines, it is still worse than anticipated. A downward adjustment to the 2002-2003 General Sales Tax estimate of \$11.4 million was approved by City Council as a part of the Annual Report, to bring that estimate in line with actual 2001-2002 collections and to reduce expectations to flat performance for the year. The first quarter General Sales Tax performance is obviously below the rate that will be necessary to achieve that revised budget expectation. In fact, performance during the remaining three quarters will have to average 2.5% growth to achieve that budget. Given recent trends, that outcome seems very unlikely.

As a continuing reminder of just how hard hit this Valley has been, our decline was considerably greater than that experienced by the San Francisco Bay Area (down 3.1%) and in comparison with the State as a whole, where collections actually grew by 3.0%. Neighboring cities in Santa Clara County also experienced fall-offs in their General Sales Tax receipts: Palo Alto (down 17.3%), Campbell (down 15.1%), Milpitas (down 15.0%), Santa Clara (down 10.2%), Cupertino (down 10.1%), Mountain View (down 8.8%), Gilroy (down 8.2%), Saratoga (down 8.0%), Morgan Hill (down 8.0%), and Sunnyvale (down 5.0%).

Preliminary information from MBIA MuniServices, the City's Sales Tax consultants, indicates that the decline in the City's Sales Tax receipts for the most recent quarter can be attributed to poor performance in most economic sectors, but was led again, not surprisingly, by another sharp decline in the Business-to-Business category (down 25.4%). The following categories also suffered significant drops: Miscellaneous (down 16.1%); Food Products (down 5.0%); Transportation (down 2.8%); Construction (down 2.7%); and General Retail (down 2.3%).

Specific areas within these economic categories are informative of General Sales Tax performance. Within the Business-to-Business category, the greatest declines were related to electronic equipment (down 35.6%), light industry (down 31.0%), leasing (down 27.2%), business services (down 27.1%), and office equipment (down 3.7%). Within the Food Products category, the greatest decline was in restaurants (down 5.5%). Within the Transportation sector, the greatest decline was in service stations (down 8.0%) and auto parts/repair (down 6.1%). The following lists the largest General Sales Tax sectors and their percentage of the total for the 2002-2003 first quarter (July through September economic activity): Business-to-Business at 29.1%; General Retail at 24.9%; Transportation at 22.1%; Food Products 13.1%; and Construction at 10.0%.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transient Occupancy Tax	\$ 7,638	\$ 1,759

TOT collections of \$1.8 million through November were well below last year's level of \$2.2 million. Adjusted for prior year accruals, receipts declined 14.4%. Performance of this tax has still not rebounded significantly from the very depressed levels suffered in the months following the September 11 events. The November occupancy rate was 52.2%, slightly below the October rate of 55.8%. In addition, reflecting the depressed hotel market, the monthly average room rate continued to fall, dropping to \$115.46 (November 2002) from \$124.07 (November 2001). The 2002-2003 Adopted Budget presumed growth in this revenue source (12.0%) over a higher than actually realized 2001-2002 collection level. Given current collection levels, it was very clear, very early in the year that the Adopted Budget level would not be achieved. As a result, a significant downward adjustment to the General Fund TOT estimate was recommended and approved by City Council in October. Continued collections at the current level will, however, necessitate a further downward reduction in this category. We will continue to monitor this situation very closely and recommend appropriate actions as part of the Mid-Year Budget Review.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Franchise Fees	\$ 34,068	\$ 12,835

Franchise Fees collections of \$12.8 million were above the November 2002 collection level of \$10.1 million. This reflects higher collections in Electric, Gas, and City-Generated Tow Franchise Fees. It should be noted, however, that most of these receipts are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on collections in 2001-2002, and are not necessarily indicative of actual expected receipts. In April 2003, PG&E will calculate the actual Franchise Fees due in 2002-2003 based on calendar year 2002 activity. At this point, no adjustments seem to be necessary.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Franchise Fees (Cont'd.)	\$ 34,068	\$ 12,835

Commercial Solid Waste Franchise Fees of \$2.5 million were approximately 6.3% below (down \$170,000) the prior year level. Due to the 2001-2002 year-end performance of this Franchise Fee and analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report. More recent projections indicate that this revenue may not even meet the revised budget level of \$9.1 million. This poor performance, again, reflects the economic climate as well as additional waste diversion being experienced in the Food Waste Program and the Construction and Demolition Diversion Program.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Utility Tax	\$ 68,102	\$ 23,647

Utility Tax collections of \$23.6 million were 6.5% (\$1.6 million) below last year's level of \$25.3 million. Due to the 2001-2002 year-end performance of Utility Taxes and analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report. More recent projections indicate that this revenue source as well may not even meet its revised budget level. The drop is primarily in the Electric Utility Tax and the Telephone Utility Tax areas.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
Licenses and Permits	\$ 62,046	\$ 26,256

Licenses and Permits revenue of \$26.3 million through November was 5.5% (down \$1.5 million) below the prior year level of \$27.8 million. Cardroom Business Tax collections (\$2.1 million) were 25.4% (down \$727,000) below the prior year level of \$2.9 million. Though collections were down 25.4%, this performance is actually an improvement over October, as that month experienced a drop of 31.0%. The November year-to-date performance was

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Licenses and Permits (Cont'd.)	\$ 61,911	\$ 26,256

primarily the result of revenue losses in the first four months of the year from Bay 101 related to its bankruptcy filing. July's revenue was down approximately 60.0% from the prior year. The rate of decline has, however, eased somewhat each subsequent month – August collections dropped by 19.0%; September by 11.0%; and October by 8.0%. The current budget allows for an overall drop of approximately 13.0%. The necessity for reductions in the estimate related to this source will be analyzed in preparation for the Mid-Year Budget Review.

As a result of prior year-end performance analysis of the Disposal Facility Tax, a downward adjustment to the current year estimate was recommended and approved by City Council in October. More recent projections, however, indicate that this revenue may not meet the revised budget level of \$16.2 million. In this case, in addition to economic impacts, the shortfall appears also due in part to market reactions to the removal of the Alternate Daily Cover exemption, approved as part of last year's budget. Apparently, a portion of the yard trimmings that typically went to City landfills in the past is now being transported to other locations (e.g., biomass facilities for energy production). The Environmental Services Department (ESD) and the Budget Office will continue to monitor landfill activity, bringing forward a report on findings in this report. Further, the Budget Office will continue to work with ESD to analyze and assess whether any additional downward adjustments should be proposed.

Fire Permit revenue of \$2.5 million continued to track below anticipated levels through November, although slightly above (1.7%) the prior year collection level. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Collections through November reflect activity levels that are below those anticipated in the budget.

Building Permit revenues of \$6.3 million tracked slightly above last year's level, but also below anticipated levels by 1.1%. Fee increases of approximately 12.0% were approved in the current budget along with a few new fees. It is too early to draw any definitive conclusions, but we believe this revenue source still has a chance to end the year within budgeted levels (\$16.55 million). As with all revenue categories, these fees will continue to be closely monitored and adjustments to the revenue estimate, if appropriate, recommended as more information becomes available.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Use of Money and Property	\$ 13,095	\$ 4,465

Use of Money and Property revenues of \$4.5 million were below both the prior year level of \$7.3 million and current year expectations, reflecting lower cash balances in many funds, including the General Fund, resulting in lower interest earnings for all funds. The General Fund cash balance for November was down to \$167.6 million, compared to the prior year's \$203.7 million, a decline of 17.7% (down \$36.1 million). The Adopted Budget for General Fund interest earnings was built anticipating a significant drop in the average cash balance for the year, but the November drop exceeded that presumption. (We assumed a drop to an average of \$185.0 million.) Clearly, November's cash balance performance was below expectations and of concern. We will closely continue monitor performance in the coming month see how actual balances, interest rates, and earnings compare to the budgeted assumptions, returning with recommended adjustments if necessary.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from Local Agencies	\$ 41,629	\$ 15,521

Revenue from Local Agencies of \$15.5 million was 3.9% (\$581,000) above the prior year level of \$14.9 million. This variance was, however, primarily driven by several earlier than anticipated payments, including the following (indicating the variance in receipts versus expected levels): Community Based Aftercare Program funding from the County (\$308,000), Enterprise Fund In-Lieu payment (\$302,000), payment from the County for the paramedic program (\$385,000), and animal services payments from other agencies (\$152,000). These earlier than anticipated receipts were partially offset by lower than anticipated collections from the Redevelopment Agency, including payment for the Convention Center lease, and other grants from local agencies that were received last year, but not expected this year. No change in the budgeted revenue estimate is currently believed necessary.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Revenue from the State of California	\$ 58,478	\$ 17,477

Revenue from the State of California totaled \$17.5 million, representing a 13.5% decline from prior year collection level of \$20.2 million. Much of this decline, however, reflects the presence last year of a \$3.0 million accrual for open space activities, (scheduled in 2001-2002 but yet to be paid by the State), from Proposition 12. Given the State budget situation, we will need to monitor closely whether those funds will, indeed, be released as originally planned.

This category also includes Motor Vehicle In-Lieu Fee (MVLFF) payments of \$17.5 million, reflecting year-to-date growth of 2.6% (\$449,000). At this point we still anticipate that this revenue source will reach the budgeted level of \$52.5 million.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Revenue from the Federal Government	\$ 2,490	\$ 907

Revenue from the Federal Government of \$907,000 was lower than the \$1.5 million received in the prior year. This performance is due to various grants not yet received but still expected, partially offset by earlier receipt of other grants. No change in the budgeted revenue estimate is currently believed necessary.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Departmental Charges		

-Public Works	\$ 6,356	\$ 2,552
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Public Works revenue of \$2.6 million was 10.3% below last year's level and 12.0% below the anticipated level. Similar to the other development fee categories, current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Activity levels have not reached those anticipated levels. In response, the Department has implemented expenditure reduction strategies to at least partially offset a shortfall which would otherwise occur by year-end. November performance reflects weak activity in the planned development, grading, and utility excavation permits categories. This situation requires close monitoring since all of the Public Works Fee Reserve was exhausted to offset shortfalls in 2001-2002. The Budget Office will continue to work with the Department to project year-end collection levels.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
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Departmental Charges (Cont'd.)

-Transportation	\$ 882	\$ 260
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Transportation revenues of \$260,000 tracked well below (40.2%) the prior year level of \$435,000. This performance was driven by lower than anticipated collections from Residential Signal Review, Residential Permit Parking, Sidewalk Repair Administrative Charges, and miscellaneous fees and charges. It appears likely that this revenue source will also end the year at lower than budgeted levels.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
-Planning	\$ 3,924	\$ 1,334

Planning revenues of \$1.3 million tracked slightly above last year's level (2.1% or \$27,000) but below anticipated levels by 8.0%. As with the other development-related revenue sources, current year revenue estimates were built assuming a continuation of the activity levels of last year along with higher fee levels approved by City Council. Revenues received in all categories are either at or above anticipated levels, except for the Non-Residential area of PD prezonings/rezonings, environmental clearance reports, site developments, and conditional use permits. The Budget Office will continue to work with the Department to analyze the drop in Non-Residential activity along with the increased activity related to Residential activity, determining whether the latter's level will continue and be sufficient to offset any shortfalls.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Other Revenue	\$ 11,590	\$ 8,076

Other Revenue collections of \$8.1 million were \$5.7 million below the prior year level of \$13.8 million. On an overall basis, however, revenues in this category are tracking within budget levels. The decline from the prior year reflects last year's booking of one-time settlement revenue from the County in the amount of \$5.5 million, and budgetarily moving the Solid Waste Enforcement Fee to the Departmental Charges (prior year's November year-to-date level at \$656,000).

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Transfers and Reimbursements	\$ 79,326	\$ 39,536

Transfers and Reimbursement collections of \$39.5 million were 15.2% above the prior year level of \$34.3 million. This performance reflects higher collections of operating and capital/special fund overhead, as well as earlier receipt of Municipal Water Rate of Return revenue.

EXPENDITURES

Through November, General Fund expenditures of \$284.6 million were 4.7% (\$12.9 million) above the prior year level of \$271.7 million. Encumbrances of \$64.8 million were 11.9% (\$6.9 million) above the prior year level of \$57.9 million. Expenditures and encumbrances (\$349.4 million) through November constitute 45.1% of the total 2002-2003 revised budgeted use of funds (\$774.8 million, excluding reserves).

With the exception of the Fire Department, the Employee Services Department and the City-Wide Workers' Compensation Claims and City Insurance appropriations, individual and cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through November. Overtime expenditures are tracking above anticipated levels, however, in the following departments: Employee Services; Fire; Finance; General Services; General Services-Parks Maintenance; Office of the City Clerk; Parks, Recreation, and Neighborhood Services; Planning, Building, and Code Enforcement; Police; and Public Works. With the exception of the Fire and Employee Services departments, though, the departments are currently generating sufficient salary savings to offset these higher overtime costs.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

The following discussion highlights General Fund expenditure issues:

KEY GENERAL FUND EXPENDITURES
((\$000's))

<u>Department</u>	<u>2002-2003</u> <u>Budget</u>	<u>YTD</u> <u>Actual</u>
Police	\$ 216,884	\$ 84,373

On an overall basis, Police Department expenditures were tracking below estimated levels through November. Although the Department's Personal Services expenditures were running at higher than expected levels (40.7% compared to 40.4% par level), this is entirely the result of continuing increased overtime usage for Airport security activities. Actions to reimburse the General Fund fully from Airport monies will be brought forward during the Mid-Year Budget Review.

As part of the continuation of the Sworn Recruitment and Training Program, the 34 Officers that were part of the July 2002 Academy are now in field training and will be street-ready in May 2003. A new academy anticipated to contain 42 recruits is scheduled to begin in January 2003. Those graduates would be expected to be street ready in October 2003.

As discussed above, overtime expenditures through November were above expected levels at \$4.2 million or 50.9% of the budgeted level (compared to the estimated level of 40.4%). It is anticipated, however, that with the exception of additional Police overtime currently being experienced at the Airport, the Department will manage its overtime to remain within the budgeted level by year-end.

The compensatory time balance at the end of November was 218,388 hours for sworn personnel, an increase of 7,664 hours from the June 2002 balance of 210,724 hours. This level represents an increase of 8,851 hours from the November 2001 balance of 209,537 hours.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Fire	\$ 108,709	\$ 45,527

Through November expenditures for the Fire Department continued to track significantly above budgeted levels. The Department's Personal Services expenditures remain the issue, tracking at much higher than budgeted levels, reflecting the combined impact of a higher than needed non-paramedic firefighter count, and a change in the method of paramedic staffing deployment. The Department currently has a total of 196 filled paramedics (124 front-line and 72 support), the highest level in the Department's history. The front-line total is, however, still 23 short of the 147 that are necessary to staff all apparatus fully. Last year, to address the paramedic staffing imbalance and stay within their budget, the Department filled front-line paramedic duty requirements by deploying both front-line and support paramedic personnel. This process has been suspended since July to conduct an assessment of the impact of "dual role" practice. This suspension has, however, resulted in the Department's Personal Services tracking significantly higher than expected.

The Department continues to work with the City Manager's Office on various strategies to reduce this gap. Coinciding with the end the Wildland Fire Season in early November, the Department redeployed personnel from four brush patrol and one water tender companies to provide coverage for Fire Engineer and Paramedic vacancies. The Department has also accelerated the accreditation process of 13 Firefighter Paramedics now on training. This will result in increasing the number of front-line Paramedics by 13 by the end of March. In addition, the Department has redeployed sworn personnel on administrative duties to the line, thereby reducing overtime usage for minimum staffing. These actions combined are expected to result in a \$1.5 million reduction in overtime usage, bringing the size of the projected year-end shortfall down somewhat, to approximately \$3.5 million.

The City Manager's Office continues to work with the Department and the union on additional strategies to address both the short-term staffing issue and to develop long-term strategies to close the gap in front-line paramedics.

Current estimates indicate that the Department's level of Non-personal/Equipment expenditures are tracking at budgeted levels.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
Employee Services	\$ 7,432	\$ 2,819

Overall Employee Services Department expenditures through November were slightly above expected levels. Departmental personal services expenditures were higher than anticipated because the department is almost fully staffed and, therefore, not achieving budgeted salary savings levels. Savings are being achieved in the non-personal/equipment budget that can at least partially offset the personal services overrun. The Budget Office will be working with the Department to assess what measures are needed to return overall department expenditures to budgeted levels, as well as achieve the savings required by the mandated cost/position management plan process.

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
Parks, Recreation, and Neighborhood Services	\$ 62,659	\$ 26,122

Parks, Recreation, and Neighborhood Services Department personal services expenditures through November were higher than anticipated (approximately 42.9%, compared to par level of 40.4%). In light of the relatively high level of vacancies in this department, the higher than anticipated expenditure level appears to reflect higher than budgeted expenditures for part-time staff and overtime to fill behind the vacant positions. The Budget Office is working with PRNS to develop measures necessary to return both expenditures to budgeted levels, and achieve the savings required by the mandated cost/position management plan process (\$1.3 million). Non-personal/equipment expenditures also still appear higher than anticipated through November, but the Department fully expects to stay within budgeted levels by year-end.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
City-Wide Strategic Support	\$ 46,226	\$ 14,251

The City-Wide Strategic Support category includes funding for Workers' Compensation Claims and general City Insurance policy costs, among many other items.

The City began to experience a spike in Worker's Compensation claims costs in the latter part of last year, and the 2001-2002 originally adopted budgeted estimate was exceeded. Through November of this year, claims payments are continuing to track well above budgeted levels. Preliminary information indicates that the problem is not an increase in claims, but rather a significant increase in the cost per claim. For example, hospital payments have increased 158% while expenses related to surgeons increased by 53%. In addition, physician and drug costs have increased by 27%. Although an augmentation of \$500,000 to this appropriation was recommended and approved by City Council as part of the Annual Report, the most recent Employee Services Department projections indicate the likelihood of a further shortfall of between \$1.5 and \$2.5 million by year-end. The Budget Office is working with the department to provide additional information and analysis, and will provide recommendations regarding this issue as part of the Mid-Year Budget Review.

As has been reported previously, the City Insurance appropriation will experience a shortfall of approximately \$149,000 by year-end. In June 2002, the City Council approved a memo from the Finance Department detailing this possible gap. The Budget Office will bring forward appropriate budget adjustment recommendations during the Mid-Year Budget Review.

CONTINGENCY RESERVE

Through November, the General Fund Contingency Reserve was down by \$62,500 from the 2002-2003 Adopted Budget level of \$24,549,175 (to \$24,486,675). This reflects the two revisions to the Contingency Reserve which have been approved during the first four months of the year:

- A decrease of \$27,500 to provide matching funds for an Office of Criminal Justice Planning "Domestic Violence" grant.
- A decrease of \$35,000 to provide for studies required to amend the General Plan related to the Almaden Youth Association Agreement.

OTHER FUNDS

Construction and Conveyance Tax Funds

Revenues for the Construction and Conveyance Tax Funds are continuing to exceed our expectations due to the increased activities in the local real estate market. The number of property transfers for all types of residences in the first five months of fiscal year 2002-2003 totaled 4,122. This is a 15.6% increase from the same period of the fiscal year 2001-2002, which totaled 3,565.

Through November, \$8.1 million in actual tax revenues has been received (50.6% of the 2002-2003 estimate of \$16 million). This collection is 5.6% higher than revenues received through November 2001. In addition to these revenues, the City has since received December Conveyance Tax receipts totaling \$1.8 million. This amount is 25% higher than the December 2001 amount of \$1.5 million. The City has also recently received January Conveyance Tax receipts totaling \$2.4 million. This figure is 14.9% lower than the January 2002 amount of \$2.8 million. The January receipt represents the first decline in the current fiscal year for this tax. Given the current state of the economy, it is anticipated these revenues may continue to decline. The 2002-2003 budgeted estimate allows for a 39% decrease from the 2001-2002 collection level. Therefore, we will continue to exercise caution when projecting these receipts.

Other Construction-Related Revenues

Construction-related tax revenues remain very depressed. As discussed above, the Santa Clara County construction industry has suffered the greatest drop in the State as the result of the economic slowdown. The year-to-date total of the seven revenue sources monitored in this category is \$9.1 million, a decrease of 5.3% from the \$9.6 million collected through the same period last year. On an overall basis, because we had correctly anticipated a significant drop in revenue, this performance is actually relatively close to adopted budget estimates that allowed for a 6.2% drop from the prior year. Much of the total, however, reflects unusually strong collections in a single month (August). Given the current economic climate, it is expected that construction-related taxes will demonstrate continued weak performance for a number of quarters to come. As a result, moderate reductions to the current year estimate, and significant reductions to projections for future collections in the out years of the five-year CIP now appear to be likely.

The major revenue sources in this category – Building and Structure Construction Taxes and Construction Excise Taxes – continue to track below last year's already weak collection patterns. Year-to-date, Construction Excise Tax revenues equal \$5.1 million (37.4% of the current 2002-2003 estimate of \$13.66 million), representing a 4.9% decrease from last year's \$5.4 million received over the same period. The budgeted estimate for this category allows for an 8.2% drop

OTHER FUNDS (CONT'D.)

Other Construction-Related Revenues (Cont'd.)

in 2002-2003. However, we again note that 45% of the total year-to-date collections were received in a single month (August). If August collections had been in line with performance of the other four months of the year, collections would be roughly 36% below last year's performance to date. Building and Structure Tax receipts through November totaled \$3.2 million (36.3% of the current 2002-2003 estimate of \$8,874,000), representing a decrease of 13.2% from the revenues collected through the same period last year (\$3.7 million). The budgeted estimate for this category allows for an 8.1% drop in 2002-2003. Again, however, without the unusually strong August performance, collections would have fallen much lower, to levels around 40% below 2001-2002 performance through November. In light of the prolonged economic slowdown, both of these revenue estimates may need to be reduced as part of the Mid-Year Budget Review.

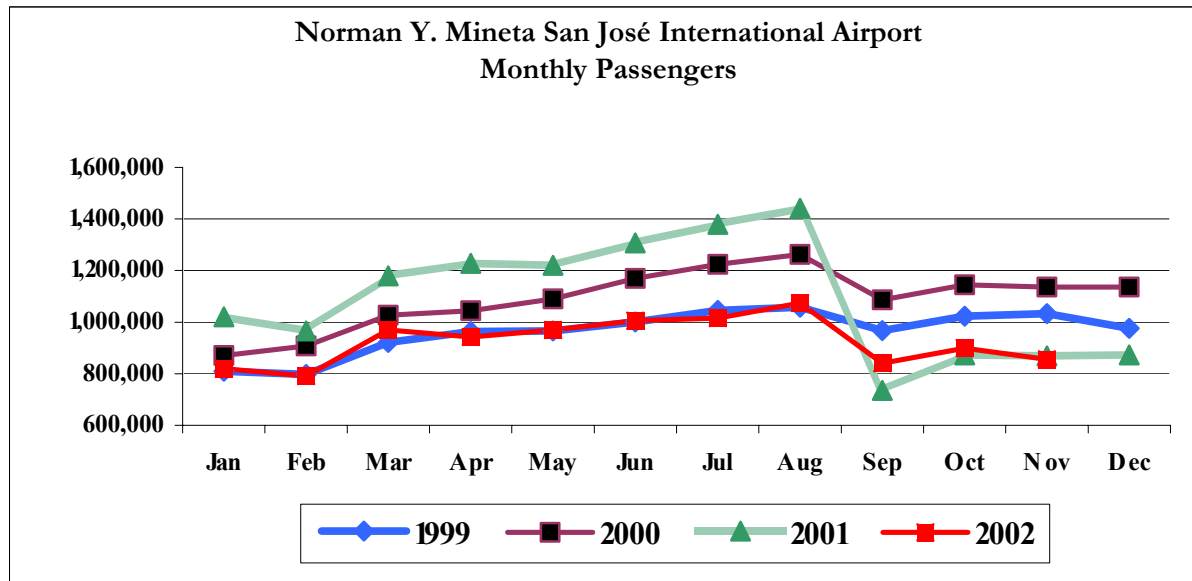
Among the smaller revenue sources in this category we are seeing a mixed performance. Sanitary Sewer Fees and Storm Drain Fees continue to outperform prior year performance. Through November, Residential Construction Taxes tracked roughly in line with the prior year, and Major Facilities Fees and Service Connection Fees tracked below prior year collection patterns. Sanitary Sewer Fee receipts totaled \$532,000 (75.6% of the current 2002-2003 estimate of \$703,000), a level well above the \$270,000 collected over the same period. Fee receipts for the Storm Drain Fees totaled \$209,000 (59.5% of the current 2002-2003 estimate of \$351,000), also well above the \$142,000 received over the same period last year. In contrast, Residential Construction Tax receipts totaled only \$28,000 (18.2% of the current estimate of \$153,000), corresponding to 43.5% of last year's receipts of \$64,000 through November. Major Facilities Fee revenues through November totaled just \$14,517 (5.8% of the current 2002-2003 estimate of \$250,000), representing a 21.7% decrease over the revenues collected through the same period last year (\$18,530). Service Connection Fee receipts through November totaled a miniscule \$1,744 (0.5% of the current 2002-2003 estimate of \$320,000), 96.3% below collections through November 2001 (\$47,287). Staff will continue to monitor these revenues closely.

Airport Funds

Activities at the Norman Y. Mineta San José International Airport (SJC) continue to be negatively impacted by the combined impact of the economy and the September 11 events. Through November 2002, SJC enplaned and deplaned just over 4.7 million passengers, 11.6% less than the prior year. November results were disappointing, reflecting a drop from last month's activity levels. The Airport served approximately 855,400 passengers. This was a 1.6% decrease from last November. Terminal C passenger activity decreased by 1.9% in monthly comparisons, and activity for the fiscal year was lower by 10.5%. For Terminal A, November passenger activity decreased by 1.5% and 12.2% for the fiscal year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)



From January through August of this year, the Airport was tracking at 1999 levels. Over the past three months, however, the number of monthly passengers has dropped below even 1999 levels. Local aviation activities are simply not showing signs of significant improvement. Major U.S. airlines continue the reduction of flight operations in response to the sharp declines in passenger activity. American Airline's current fiscal year passenger levels in San José, for example, are 23.4% lower than the previous fiscal year. Other carriers posting significantly reduced fiscal year passenger totals include United, Continental, and Delta. Southwest, Northwest, Mexicana, Horizon, and Skywest are the only scheduled San José passenger carriers that experienced growth over last fiscal year. Skywest's fiscal year totals continue to be greatly impacted by the airline's increased role as United's regional carrier to Los Angeles as part of United's expanded Express service.

Fiscal year-to-date mail, freight and cargo poundage totaled 129.7 million pounds, which represents a 0.8% decrease from 2001-2002. The decrease is largely attributable to a 46.6% reduction in mail and a 16.0% drop in freight. However, international cargo and domestic cargo are up by 14.1% and 3.6%, respectively, from the prior year.

Overall year-to-date revenue collections in the Airport Revenue Fund are tracking at approximately 7.0% below anticipated budgeted levels. Airfield, terminal concessions and miscellaneous rents, parking and roadway, and general and non-aviation revenues are all below expected budget levels. The decreases are partially reduced by increases in landing fees, terminal rentals, and petroleum program revenues.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)

The Airport expects that the lower than anticipated revenue collections will necessitate downward mid-year adjustments of approximately \$4.0 million. It is anticipated that these adjustments can be made using prior year surplus funds so that no significant reductions to operational activities will be required.

As discussed previously, Airport Police overtime costs are anticipated to exceed the current overtime allocation again. The Airport and Police Departments are currently reviewing year-to-date overtime expenditures. It is anticipated that Airport funding will be recommended for allocation during the Mid-Year Budget Review process to fund the overtime costs.

The Airport Maintenance and Operations (M&O) Fund expenditures through November tracked below budgeted levels in both personal and non-personal services. Personal services expenditures were 38.3% of budget compared to the prorated budget level of 40.4%. Personal services savings are attributed to departmental vacancies maintained through hiring controls implemented by the Airport, and reduced overtime expenditures. Through November, the Airport had 58 vacancies, 31 of which were defunded for 2002-2003. The remaining 27 positions are funded and three of these positions are currently backfilled. Non-personal/Equipment expenditures through November, excluding encumbrances, totaled 24.4% of budget, and tracked below estimated levels of 29.2%. Encumbrances of \$18.6 million bring total Non-personal/Equipment Services commitments to 69.0% of budget. Non-personal savings in the Airport's M&O Fund is primarily the result of lower than anticipated contractual services expenditures.

Year-to-date expenditures in the Airport Customer Facilities and Transportation Fee Fund were at 89.0% of the anticipated budget level. Expenditure savings are primarily due to continued refinements/decreases in the number of bus service hours scheduled – the Airport and its contractors are working to ensure that balance between costs and service hours are adjusted to meet seasonal demands. November's average daily shuttle bus ridership was only 79.0% of November 2001.

Through November, the total Passenger Facility Charge (PFC) revenue was approximately \$5.7 million. This year-to-date amount includes only a portion of the October 2002 revenues. Additional October PFC revenues in the amount of \$1.8 million were received in the first two weeks of December. Total PFC revenue through October of \$7.4 million is 3.6% below the anticipated year-to-date level. The Airport expects that this lower than estimated revenue collection will require a downward mid-year adjustment of approximately \$2.9 million.

The Airport clearly faces a challenging task in the months ahead to maintain reasonable rates charged to Airlines, while minimizing the impact to its customers. A more detailed report of the Airport operating fund revenue and expenditure status will be provided as part of the Mid-Year Budget Review.

OTHER FUNDS (Cont'd.)

Transient Occupancy Tax Fund

TOT Fund collections of \$1.9 million through November were dramatically below last year's level of \$3.3 million. Although the drop is somewhat overstated due to a prior year accrual, the decline is still cause for concern. Excluding accruals the decline was approximately 13.0%. As was described above for General Fund Transient Occupancy Tax collections, performance of this tax has simply not rebounded from the depressed levels suffered in the months following the immediate aftermath of the September 11 events, and collections have remained sluggish into the current fiscal year. The November occupancy rate was 52.2%, slightly below the October rate of 55.8%. The monthly average room rate dropped to \$115.46 (November 2002) from \$124.07 (November 2001). Given current collection levels, it is very clear that the Adopted Budget level will not be achieved. Due to the lower than expected 2001-2002 collection level of \$1.05 million, in October, reductions of \$262,740 for the Convention and Visitor Bureau and the Arts Groups allocation were approved by City Council, as was a reduction of \$525,420 to the Conventions, Arts, and Entertainment Department (CAE).

Given current collection levels, it is almost certain that a significant downward adjustment to the Adopted TOT Fund revenue estimate will need to be implemented as part of the Mid-Year Budget Review. This action will result in further decreases to revenue available for allocation to the three TOT Fund recipients. The potential impact could be reductions of as much as \$1.3 million for CAE, and \$650,000 for the Convention and Visitor Bureau and Arts Groups. All three recipients were informed and asked to develop plans to address the reduced funding levels.

Convention and Cultural Affairs Fund

Overall, revenues in the Convention and Cultural Affairs Fund were lower than expected through November. Though Convention Center occupancy was near 75.0%, the anticipated shortfall of \$750,000-\$1.1 million is primarily driven by lower concessionary income (e.g., food and beverage). The Conventions, Arts, and Entertainment Department continues to work on creating a plan that would reduce both revenue and expenditure budgets. Proposed adjustments will be recommended during the Mid-Year Budget Review.

Unemployment Insurance Fund

Claims expenditures in the Unemployment Insurance Fund are now projected to end the year slightly over budgeted levels. Due to the high unemployment rate in Santa Clara County, combined with an increased benefit approved by the State effective at the beginning of the calendar year, expenditures are tracking above estimated levels. This fund will be monitored closely and Mid-Year action likely recommended.

CONCLUSION

Economic indicators and City revenue collections confirm the fact that we continue to be mired in a severe local economic downturn from which we should not expect significant relief in the immediate future. Given the latest General Sales Tax receipt information and our assessment of other economically impacted revenue sources, it appears likely that additional budgetary adjustments will be necessary at mid-year to reflect the fiscal situation. Such recommendations, as appropriate, will be provided as part of the Mid-Year Budget Review.

Although the severity of the economic situation is greater than anticipated, the fact that we were going to experience a downturn was not a surprise. Based on our projections, the Administration and the City Council have acted prudently over the last two years to prepare for this situation. Surplus prior year funds were diverted from the previously scheduled establishment of new projects, and used instead to fund reserves to address the downturn. Approximately 15 months ago, the Administration implemented hiring and expenditure controls that continue today, and we have begun planning efforts early this year to develop plans to bring the budget for 2003-2004 into balance. The combined impact of these various measures will assist in weathering the economic downturn, but still leave us with additional work ahead to brace for the future. Further, while the final impact of the State budget is yet to be determined, current estimates place the City at risk of losing a cumulative \$57.2 million. This prospect requires that we continue to monitor our current year financial status and prepare the organization for next year.

We will continue to closely monitor events, and report monthly through this process. As mentioned above, we will also bring a comprehensive review of all City Funds, along with recommendations for adjustments that appear necessary and appropriate to revenue and/or expenditure budgets, to City Council as part of the Mid-year Budget Review report scheduled to be released at the end of January.

LARRY D. LISENBEE
Budget Director